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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 269

ANTONIO RULLAN, PETITIONER

v.

RAFAEL BUSCAGLIA, TREASURER OF PUERTO RICO,
ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIRST
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of Puerto Rico (R. 10-21) and the opinion of the Supreme Court of Puerto Rico (R. 26-30) are contained in the record in English translation and are not yet reported. The opinion of the Court of Appeals (R. 74-80) is reported at 168 F. 2d 401.

JURISDICTION

The judgment of the Court of Appeals was entered on June 14, 1948. (R. 80.) The petition

for a writ of certiorari was filed on September 10, 1948. The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. 1254.

QUESTIONS PRESENTED

1. Whether the court below was correct in ruling that the decision of the insular Supreme Court was not manifestly erroneous in construing Section 16 (a)(2) of the insular Income Tax Act, as amended, to deny deductions of interest paid between members of a family.

2. Whether the court below was correct in holding that this insular statute, so construed, does not violate the due process, equal protection and uniformity of taxation clauses of the Organic Act of Puerto Rico.

STATUTES INVOLVED

Organic Act of Puerto Rico (Act of March 2, 1917), c. 145, 39 Stat. 951, as amended by the Act of May 17, 1932, c. 190, 47 Stat. 158:

SEC. 2. That no law shall be enacted in Puerto Rico which shall deprive any person of life, liberty, or property without due process of law, or deny to any person therein the equal protection of the laws.

* * *

That the rule of taxation in Puerto Rico shall be uniform.

* * *

(48 U.S.C. 1946 ed., Sec. 737.)

Laws of Puerto Rico (1941), pp. 478, 494, 496, Act No. 31, approved April 12, 1941, amending Act No. 74, approved August 6, 1925, as amended (Income Tax Act):

SECTION 8.—Section 16 of said Act is hereby amended to read as follows:

“SECTION 16.—(a) In computing net income there shall be allowed as deductions:

* * *

“(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred, or continued, to purchase or carry obligations title or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; *Provided*, That no interest is deductible if it is payable between members of one family or between an individual and a corporation with respect to which the individual is the direct or indirect owner of more than fifty (50) per cent of the value of the outstanding stock; or (c) between corporations with respect to which one same individual or corporation is the direct or indirect owner of more than fifty (50) per cent of the outstanding stock of each of said corporation; or (d) are two corporations one of which is the direct or indirect owner of more than fifty (50) per cent of the outstandig [sic] stock of the other corporation.”

STATEMENT

This case involves an income tax deficiency assessed by the Treasurer of Puerto Rico against taxpayer for the calendar year 1942 in the amount of \$9,092.18, with interest from March 15, 1943. (R. 4-5, 9.) The essential facts, which are not in dispute (R. 74), were found by the courts below as follows (R. 26-28, 75):

Jose, Salvador and taxpayer, Antonio Rullan, were brothers and the principal stockholders of Sucs. de A. Mayol & Company, Inc. On June 19, 1940, Jose and Salvador each sold to taxpayer Antonio 400 shares owned by them in this corporation at the par value of \$100 a share. There was no written contract but it was agreed that taxpayer Antonio would pay to Jose and Salvador "annual interest at 8% on the whole amount as well as the value thereof, 'whenever he wished.'" (R. 75.)

The Rullan brothers do not keep any accounting books, and the sale of the shares was entered only in the stockholder and transfer book and in the journal and ledger of the corporation. Taxpayer made no payment to his brothers in the years 1940 and 1941, but in October, 1942, he paid to each one the amount of \$7,476.66 as interest on the par value of the shares at the rate of 8% annually. In his income tax return for 1942 taxpayer deducted, not only these interest payments, but also other payments which he made to his brothers for interest on personal loans. All three of the

brothers filed their returns on the cash basis. Jose and Salvador reported on their returns the interest paid by taxpayer Antonio to them in 1942 on the value of their shares. Taxpayer paid the income tax on dividends which he received for the 800 shares he had purchased from his brothers. There is no controversy either as to the legitimacy of the transaction or as to the entries appearing on the books of the corporation. The sole question presented to the courts below was whether or not the interest paid by taxpayer to his brothers is deductible from the gross income for the taxable year 1942. (R. 75.)

The litigation originated in the Tax Court of Puerto Rico, to which taxpayer appealed for redetermination of the Treasurer's assessment. (R. 4-7, 27.) The Tax Court sustained taxpayer's complaint (R. 10-21), but was reversed by the insular Supreme Court (R. 26-30). The Supreme Court also denied taxpayer's motion for reconsideration. (R. 30-37.) Upon taxpayer's appeal the court below affirmed the insular Supreme Court. (R. 74-80.)

ARGUMENT

1. The question whether the insular Supreme Court correctly construed the controlling local statute *to deny interest deduction in intra-family

* "That no interest is deductible if it is payable between members of one family" (Laws of Puerto Rico (1941), Act No. 31, approved April 12, 1941, Section 8, amending Act No. 74, approved August 6, 1925, Section 16, *supra*, p. 3)

transactions, where "paid" or "accrued", is clearly a question of local tax law. Hence, upon well settled principles, the court below was required to sustain the interpretation by the local court of the local taxing act, unless manifestly erroneous or contrary to recognized principles of local law or established practices of the local community. *Bonet v. Yabucoa Sugar Co.*, 306 U. S. 505, 510; *Bonet v. Texas Co.*, 308 U. S. 463, 471; *De Castro v. Board of Comm'rs*, 322 U. S. 451. Taxpayer's contention that the judgments of the insular Supreme Court and of the court below are "patently and inescapably wrong as a matter of local law" (Br. 11) is refuted by the reasons succinctly stated in the opinions of those courts (R. 28-30, 75-78). Taxpayer's contention is plainly without merit, and further discussion in addition to that contained in these opinions would serve no useful purpose.

2. The insular statutory provisions here involved, as construed below, are uniformly applicable in every part of Puerto Rico. Hence, contrary to taxpayer's further contention (Br. 28-32), the statute involved does not violate the clause of the Organic Act providing: "That the rule of taxation in Puerto Rico shall be uniform", *supra*, p. 2. It is well settled that the analogous provision of Article 1, Section 8, of the Federal Constitution that "all Duties, Imposts and Excises shall be uniform throughout the United

States," requires only geographical uniformity. *Knowlton v. Moore*, 178 U. S. 41, 92; *Brushaber v. Union Pac. R. R.*, 240 U. S. 1, 24. It is equally clear that when Congress incorporated the requirement of uniformity in the Organic Act, it intended the same meaning that had always been attributed to it in the Constitution, as the court below explicitly held in *Ballester-Ripoll v. Court of Tax Appeals of P. R.*, 142 F. 2d 11, 18, certiorari denied,, 323 U. S. 723. In *South Porto Rico Sugar Co. v. Buscaglia*, 154 F. 2d 96, 100, the court below once more re-examined and reaffirmed the principle that the uniformity provision exacts only geographical and not intrinsic uniformity. Taxpayer recognizes here (Br. 28-29), as he did in the court below, that the two cases last cited constitute authorities contrary to his contention. If taxpayer's contention were upheld, many serious questions involving insular taxation long regarded as fixed by administrative practice and judicial decision would become unsettled, such for example, as the progressive rates of taxation embodied in the Income Tax Act, sustained in the *Ballester-Ripoll* case, *supra*.

Taxpayer's further contention that the insular statute, as construed, violates the due process and equal protection clauses of the Organic Act, *supra*, p. 2, is equally without foundation. The legislative classification does not constitute a hostile and oppressive discrimination against particular persons, and being neither arbitrary nor confisca-

tory, does not deny due process nor equal protection of the laws. *Madden v. Kentucky*, 309 U. S. 83; *South Porto Rico Sugar Co. v. Buscaglia*, *supra*, p. 100.

The classification may be based, among others, upon the evidentiary difficulties peculiar to claims for interest deductions on intra-family transactions. Irrespective of good faith, the evidence material in these cases is peculiarly within the knowledge and control of taxpayer and inaccessible to the taxing authorities. The record here illustrates difficulties typical in intra-family transactions, on the basis of which the legislature might reasonably conclude in the public interest, without hostile or invidious purpose, and in the exercise of its discretion, that the prior law was defective. Thus, while the *bona fides* of the instant transaction is not open to dispute, it was not conducted as would be a business transaction. For example, there was no written contract for the loan of \$80,000 at 8% interest (R. 27, 54-55, 57, 75), no security was given (R. 57), principal and interest concededly were payable whenever taxpayer wished (R. 27, 55, 75); and indeed, no interest whatsoever was paid for over two years (R. 27, 57-58, 75). The brother, Jose, one of the creditors, was taxpayer's attorney-in-fact and represented him "in everything" (R. 53); and finally, no cash actually ever passed, the entire transaction being a bookkeeping one (R. 58, 61). Further, the legislature may not have regarded even legally genuine intra-family

interest obligations to result in economically real transactions, inasmuch as the common characteristic of such groups is that their members, although distinct legal entities, generally have a near identity of economic interests. See *McWilliams v. Commissioner*, 331 U. S. 694.

In any event, taxpayer has not sustained the heavy burden imposed upon him of negating every conceivable basis which might support the assailed legislation. *Madden v. Kentucky*, *supra*, p. 88.

CONCLUSION

The decision of the court below is correct and no question warranting further review is presented. The petition for a writ of certiorari should be denied.

Respectfully submitted,

✓ PHILIP B. PERLMAN,
Solicitor General.
 ✓ THERON LAMAR CAUDLE,
Assistant Attorney General.
 ✓ ELLIS N. SLACK,
 ✓ I. HENRY KUTZ,
Special Assistants to the
Attorney General.

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